IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
LUBBOCK DIVISION

IN RE:	§	
	§	
GEORGE COURTNEY BIGGERSTAFF AND VEARLY DEAN BIGGERSTAFF,	§	CASE NO. 02-50962-RLJ-7
	§	
	§	
DEBTORS	§	
MAX R. TARBOX, CHAPTER 7 TRUSTEE,	§	
	§	
	§	
Plaintiff	§	
	§	
VS.	§	ADVERSARY NO. 03-5074
	§	
SORIS, A DIVISION OF CASE CREDIT CORPORATION,	§	
	§	
	§	
Defendant	§	

MEMORANDUM OPINION

This adversary proceeding concerns whether Max R. Tarbox, the Chapter 7 Trustee, may, under section 544 of the Bankruptcy Code, avoid the lien of Soris, a Division of Case Credit Corporation, against a 2001 Western Star 4964EX White Truck. Trial was held on May 25, 2004. This matter is subject to the court's core jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157. This Memorandum Opinion contains the court's findings of fact and conclusions of law. FED. R. BANKR. P. 7052 and FED. R. BANKR. P. 9014.

Statement of Facts

The facts are not disputed. On February 9, 2000, the Debtors financed the purchase of the 2001 Western Star 4964EX White Truck (the "Truck"), under a retail installment contract and security agreement (the "Contract"). Soris, a Division of Case Credit Corporation ("Soris"), is the owner and holder of the Contract. Soris perfected its security interest against the Truck by notation of its lien on the certificate of title. On September 19, 2002, without the debt under the Contract having been paid, Soris mistakenly signed the release of lien provision on the certificate of title, stamped the Contract "PAID," and forwarded both the title and the Contract to the Debtors. The Debtors did not present the original certificate of title, with the signed release, to the county assessor-collector in order to have a new certificate of title issued for the Truck. A new certificate of title for the Truck was never issued by the Texas Department of Transportation indicating that Soris's lien had been released.

The Debtors filed for relief under Chapter 7 of the Bankruptcy Code on August 19, 2003. The Debtors included Soris as an unsecured creditor in their bankruptcy schedules. As of the date of the bankruptcy filing, the payoff indebtedness under the Contract was approximately $70,900. After receiving notice of the Debtors' bankruptcy filing, Soris discovered that it had mistakenly signed the release provision on the certificate of title and had stamped the Contract "PAID." On September 8, 2003, Soris obtained from the Texas Department of Transportation a certified copy of the original certificate of title which still reflected Soris as the first lienholder against the Truck.

On October 24, 2003, the Trustee filed his motion to sell the Truck. The motion recognized the lien dispute with Soris and provided that should the court determine that Soris has a valid lien then Soris agreed to the following distribution of proceeds:

Commission to Trustee:	$ 3,500
Balance to Soris:	$31,500

The motion further provided that the Trustee would hold the funds derived from the sale in the Trustee's account until such time as the lien dispute between the Trustee and Soris is resolved. If resolved in Soris's favor, the Trustee will distribute the $31,500 to Soris. The sale was authorized by the court by order entered November 7, 2003. The Truck was sold to Lubbock Truck Sales, Lubbock, Texas, for $35,000.

Discussion

The parties do not dispute the amount of the indebtedness still owing to Soris or that the Debtors' interest in the Truck, as between the Debtors and Soris, remains subject to Soris's security interest. Instead, the focus of this dispute rests upon the perfected status of Soris's lien as against the Trustee standing in the shoes of a lien creditor or bona fide purchaser. The Trustee argues that he may avoid Soris's unperfected lien through the exercise of the Trustee's strong-arm powers under 11 U.S.C. § 544(a)(1). Soris contends that its lien was still properly perfected under Texas law as of the date the petition was filed, notwithstanding its accidental notations on the certificate of title of releasing the lien and marking the Contract as paid. Additionally, Soris contends that its lien remained in force because the Debtors failed to exchange the certificate of title for a new or "clean" certificate of title showing no lienholder.

Strong Arm Power

A Chapter 7 trustee may avoid a transfer that is voidable by a hypothetical judicial lien creditor. 11 U.S.C. § 544(a)(1); *See also* 5 Collier on Bankruptcy ¶ 544.05 (15th ed. rev. 2003). As a hypothetical lien creditor, the trustee may avoid a security interest that is unperfected as of the date of the commencement of the case. TEX. BUS. & COM. CODE ANN. § 9.317(a)(2) (Vernon 2002); *id. See, e.g., Mitchell Coach Mfg. Co., Inc. v. Stephens*, 19 F.Supp. 2d 1227, 1235-36 (N.D. Okla. 1998) (applying Texas law). In this case, whether or not Soris was properly perfected as of the commencement of the case is governed by the applicable Texas Certificate of Title Act provisions. *See* TEX. BUS. & COM. CODE ANN. § 9.311(a)(2) (Vernon 2002); *Stanton v. Texas Drug Co. (In re Stanton)*, 254 B.R. 357, 361-62 (Bankr. E.D. Tex. 2000) ("The determination of whether a creditor has properly perfected its security interest is also governed by state law"); *In re Hancock*, 126 B.R. 270, 272-73 (Bankr. E.D. Tex. 1991) (discussing that trustee, as lien creditor, could avoid an unperfected lien on a vehicle under the strong arm powers of 11 U.S.C. § 544(a)(1)).

Texas Certificate of Title Act

In Texas, a security interest in a motor vehicle is properly perfected by recording the security interest on the vehicle's certificate of title. TEX. TRANSP. CODE ANN § 501.111(a) (Vernon 2001). The lienholder is entitled to retain the original certificate of title until the loan is satisfied. *See* TEX. TRANSP. CODE ANN § 501.027 (Vernon 2001); *Dota v. First National Bank of El Campo (In re Dota)*, 288 B.R. 448, 460 (Bankr. S.D. Tex. 2003). When the debt is satisfied, the lienholder must return the certificate of title to the owner along with a statement that

the lien has been released. *See id.*; TEX. TRANSP. CODE ANN § 501.115 (Vernon Supp. 2004). The owner then has the option to exchange the certificate of title and discharge of lien to the county assessor-collector for a new or "clean" certificate of title that does not reflect the prior lien. *See* TEX. TRANSP. CODE ANN § 501.115 (Vernon Supp. 2004).

In this case, the certificate of title shows that Soris took a first lien on the Truck on February 9, 2000. The title also states that this first lien was subsequently released on September 19, 2002.[1] The release of lien is accompanied by the stamp of Soris, along with a signature of an authorized agent of Soris. After receiving the certificate of title from Soris, the Debtors did not attempt to exchange the certificate of title for a new or "clean" certificate of title. Up until the filing of their petition in bankruptcy, the Debtors held the original certificate of title, which shows on its face that Soris's lien was released on September 19, 2002.

Soris asks this court to effectively disregard these actions and hold that the lien remains perfected notwithstanding the notations on the certificate of title. Soris's argument is based on the fact that the loan had not been satisfied when the release was executed, and that the Debtors failed to present the certificate of title to the Texas Department of Transportation for a new or "clean" certificate of title. For the following reasons, this court holds that the actions of Soris were sufficient to deem it unperfected as of the commencement of this bankruptcy case.

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[1] Section 501.115 appears to contemplate that the discharge of lien will be on a separate document than the certificate of title. However, the certificate of title as issued by the Department of Transportation includes blanks to be filled in by the lienholder upon release of the lien. The court finds no reason to doubt that filling in these provisions on the actual certificate itself effectively releases any such lien.

Perfection

Lienholders perfect their security interests to give constructive notice to the world of their interest in the covered collateral. *See, e.g., Jones v. Cooper Indus., Inc.*, 938 S.W.2d 118, 122 (Tex. App.–Houston[14th Dist.] 1996, writ denied). Such is the balance between lienholders and subsequent parties; lienholders are protected to the extent they have taken sufficient steps to provide the world with notice of their claim. *See, e.g., In re Hancock*, 126 B.R. 270, 272-73 (Bankr. E.D. Tex. 1991). Whether the subsequent party is an otherwise sympathetic bona fide purchaser of the property in question without notice of the lien, or, as in this case, the bankruptcy trustee as lien creditor, the issue remains the same regarding perfection: on the operative date, had the lienholder taken sufficient steps to make its claim known to the world? *See* TEX. BUS. & COM. CODE ANN. 9.317(a) & (b) (Vernon 2001); *id.; Thompson v. Apollo Paint & Body Shop*, 768 S.W.2d 373, 376 (Tex. App.–Houston [14th Dist.] 1989, writ denied).

Unless the vehicle is inventory held by a dealer, the Texas Certificate of Title Act provides that notation of the lien on the certificate of title is the exclusive means by which a lienholder makes its claim to the vehicle known to the world. TEX. TRANSP. CODE ANN § 501.111 (Vernon 2001); *Apeco Corp. v. Bishop Mobile Homes, Inc.*, 506 S.W.2d 711, 717 (Tex. Civ. App.–Corpus Christi 1974, writ ref'd n.r.e.) ("In Texas, a security interest in a vehicle may be perfected in two ways. If the vehicle is part of inventory, the security interest must be filed with the Secretary of State . . . . In all other cases, the security interest must be noted on the certificate of title."); *In re Gray*, 285 B.R. 379, 382 n.2 (Bankr. N.D. Tex. 2002). The Texas Certificate of Title Act allows the lienholder to retain the certificate of title until the loan has been satisfied. *See* TEX. TRANSP.

CODE ANN. § 501.027(b) (Vernon Supp. 2004); *Dota v. First National Bank of El Campo (In re Dota)*, 288 B.R. 448, 460 (S.D. Tex. 2003). Additionally, the Texas Certificate of Title Act provides that any sale is void if the owner does not transfer the certificate of title at the time of the sale. TEX. TRANSP. CODE ANN § 501.071 and 501.073 (Vernon 2001). Thus a lienholder holds complete power over the disposition of its collateral as no valid sale can occur prior to satisfaction of the debt without the involvement of the lienholder. *See id.*

Sections 501.071, 501.073, and 501.111 – 501.134 of the Texas Transportation Code dictate that notations on certificates of title are intended to be the exclusive means by which lenders make their liens known to subsequent purchasers of a vehicle covered by the Texas Certificate of Title Act. Because of the obvious importance of such notation, a defect in any such notation must operate to the detriment of the lienholder over a subsequent purchaser of the vehicle. *See In re Hancock*, 126 B.R. 270, 272-73 (Bankr. E.D. Tex. 1991) (discussing that a failure to perfect lien on vehicle by notation on certificate of title subordinates lienholder's claim as to trustee under 11 U.S.C. § 544); *Thompson v. Apollo Paint & Body Shop*, 768 S.W.2d 373, 376 (Tex. App.–Houston [14th Dist.] 1989, writ denied) ("The purchaser of an automobile under an original certificate of title from one in possession of the vehicle is entitled to rely on these indicia of ownership by the seller. He is not . . . under a duty to look further."). Just as the complete failure to initially note such a lien on the certificate of title would deem a lienholder unperfected as to a subsequent bona fide purchaser of the vehicle, a subsequent act by the lienholder that creates the impression that the owner holds clear title to the vehicle should also deem the lienholder unperfected as to a subsequent bona fide purchaser. *See Hancock*, 126 B.R. at 272-73;

Thompson, 768 S.W.2d at 376. If this court were analyzing the perfection of Soris as to a subsequent purchaser of the vehicle, the court is convinced that the certificate of title at issue, in which Soris purports to release any such lien against the vehicle, would be deemed unperfected as to that purchaser. The court is persuaded by the reasoning employed by another court:

> Inevitably, there will be occasions when the information regarding the status of liens contained in a certificate of title will be in error. If the erroneous information is a notation that no liens exist against the vehicle, the interest of the *bona fide* purchaser for value prevails over the interest of the creditor with a security interest in the motor vehicle. This rule applies whether the error was the result of an innocent mistake or, as in this case, of fraudulent acts by the owner. A rule which allowed reliance on the absence of lien notations on a certificate of title if such absence resulted from an innocent mistake or clerical error but not if such absence resulted from fraud would negate any ability to rely on the certificate of title. Under such a rule, a potential purchaser or lender would always have to conduct an independent search to determine if, in fact, there are no liens against the vehicle . . . .

Toyota Motor Credit Corp. v. C.L. Hyman Auto Wholesale, Inc., 506 S.E.2d 14, 15-16 (Va. 1998) (internal citations omitted) (emphasis in original). A purchaser of a vehicle is entitled to rely on the notations found on the original certificate of title when purchasing the automobile from the owner. *See Thompson*, 768 S.W.2d at 376. Any other result would require a purchaser to inquire further into any such possible claims when contemplating the purchase of a vehicle accompanied by a facially clean title. *Id.* This court does not read the statute to impose such a requirement. *Id.*

Soris's Arguments

Soris argues that the its lien should prevail over the Chapter 7 Trustee because (1) the Debtors had not satisfied the underlying indebtedness owing on the vehicle, and (2) the Debtors did not exchange the certificate of title evidencing the prior, discharged lien for a new or "clean"

certificate of title. Soris's arguments are not without support from existing case law. In *Smith v. American Honda Finance Corporation*, 266 B.R. 554, (Bankr. M.D. Ga. 2001) and *Hope v. Bank of Upson (In re Corley)*, 2001 WL 1855336 (Bankr. M.D. Ga. Aug. 1, 2001), the bankruptcy court for the Middle District of Georgia was faced with virtually the same set of circumstances as in this case – a lienholder against a titled vehicle releasing its lien in error. In *Smith*, the court was interpreting the applicable perfection statutes of Alabama. *Smith*, 266 B.R. at 555-57. In *Hope*, the court was interpreting the applicable perfection statutes of Georgia. *Hope*, 2001 WL 1855336. The court held that the lienholders remained perfected and therefore prevailed over the trustee. *Smith*, 266 B.R. at 555-57; *id.*

In *Smith*, the court based its holding on the language of the Section 32-8-64(a) of the Alabama Code, which states:

> Upon the satisfaction of a security interest in a vehicle for which the certificate of title is in the possession of the lienholder, he shall, within 10 days after demand execute a release of his security interest, in the space provided . . . and mail or deliver the certificate and release to the next lienholder named therein, or, if none, to the owner .... The owner . . . *shall* promptly cause the certificate and release to be mailed or delivered to the department, which shall release lienholder's rights on the certificate or issue a new certificate.

Smith, 266 B.R. at 556 (emphasis added). The court held that, based upon a plain reading of the statute, three steps must be completed to effect a valid lien release: "(1) execution of a release on the certificate; (2) delivery of the certificate to the next lienholder or owner; and (3) delivery of the certificate to the [Department of Revenue] by the next lienholder or owner." *Id.* at 555-56. In addition, the court found that, given the introductory language of the statute, "[u]pon the

satisfaction of a security interest . . . ," full payment of the debt is a prerequisite for a release to be valid. *Id.* at 556.

In *Hope*, the court construed the Georgia statute, which states as follows:

> (a)(1) If any security interest or lien listed on a certificate of title is satisfied, the holder thereof shall, within ten days after demand, execute a release in the form the commissioner prescribes and mail or deliver the release to the owner, . . .
> . . .
> (b) The owner *may* then forward the certificate of title, the release, the properly executed title application, and title application fee to the commissioner or the commissioner's duly authorized county tag agent, and the commissioner or authorized county tag agent shall release the security interest or lien on the certificate or issue a new certificate and mail or deliver the certificate to the owner.

Hope, 2001 WL 1855336 (emphasis added). Though similar to the Alabama statute, the Georgia statute does not contain the mandatory language regarding the submission of the executed release of the title to the appropriate authority (in Georgia, the "commissioner"). Despite this distinction, the bankruptcy court followed its prior holding in *Smith* and ruled that the lienholder, a bank, was still perfected.

This court is of the opinion that the Texas statute dictates a different result. It provides, in pertinent part, as follows:

> (a) When a debt or claim secured by a lien has been satisfied, the lienholder shall, within a reasonable time not to exceed the maximum time allowed by Section 348.408, Finance Code, execute and deliver to the owner, or the owner's designee, a discharge of the lien on a form prescribed by the department.
>
> (b) The owner *may* present the discharge and certificate of title to the county assessor-collector with an application for a new certificate of title and the department shall issue a new certificate of title.

TEX. TRANSP. CODE ANN § 501.115 (Vernon Supp. 2004) (emphasis added). As set forth above, under the Texas provision, perfection of the lien is achieved by notation on the original title. The lien is released by a notation on the title, as well. Upon receiving title back from the lienholder after discharge, the owner *may* submit the released title to the county assessor-collector and obtain a clean title. A plain reading of this provision does not lead to the conclusion that a submission of the discharged title to the county assessor-collector or to some other authority (such as the Texas Department of Motor Vehicles) is a prerequisite to holding a validly released title. A bona fide purchaser of the vehicle may rely on the certificate of title; nothing in the statute requires that such purchaser make further inquiry.

Both *Smith* and *Hope* reason that satisfaction of the lien, *i.e.* payment of the debt, is a condition to the release being valid. Such rationale implies that a lienholder cannot validly release its lien prior to the debt being paid, even if the lender actually intends to release the lien. The Texas statute merely provides that upon satisfaction of the lien, the lienholder is required to execute a discharge of the lien.

The court's construction of the Texas Title Act in light of the issue raised is consistent with the treatment of termination statements under Article 9 of the Texas Business and Commerce Code. Section 9.513 provides a mechanism by which the lienholder must timely file, or in some cases remit to the debtor, a termination statement regarding collateral subject of a financing statement. In the case of a mistakenly filed termination statement, courts have not provided relief to the lienholder by imposing a requirement that the underlying indebtedness be satisfied for the release to be effective, and instead, have held the creditor unperfected because of its actions. *See*

In re Kitchin Equip. Co. of Virginia, Inc., 960 F.2d 1242, 1246 (4th Cir. 1992) ("[Creditor] contends that the release it filed cannot be considered a termination statement . . . because [the statute] requires that such a statement be filed after there is no outstanding secured obligation . . . . [W]e are not persuaded."); *In re York Chemical Indus., Inc.*, 30 B.R. 583, 585 (Bankr. S.C. 1983) ("plaintiff is responsible for having terminated its financing statement – albeit unintentionally and inadvertently."); *J.I. Case Credit Corp. v. Foos*, 717 P.2d 1064, 1066 (Kan. App. 1986) ("What was the effect of [the creditor's] improvident filing of a termination statement? In our opinion, under K.S.A. 84-9-404, [the creditor's] security interest was at that moment no longer perfected."). The court views section 501.115 as merely creating a mechanism by which the lienholder must timely remit the title to the owner upon satisfaction of the debt. To the extent the court's interpretation of the Texas Title Act is inconsistent with the rationale of *Smith* and *Hope*, this court respectfully disagrees with such opinions.

Conclusion

Upon the foregoing authorities, the court holds that Soris, by mistakenly discharging its lien on the certificate of title, rendered its lien unperfected as of the commencement of the bankruptcy case and the Trustee avoids the lien of Soris under section 544(a)(1) of the Bankruptcy Code.

SIGNED June 23, 2004.

ROBERT L. JONES
UNITED STATES BANKRUPTCY JUDGE